

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B02

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Date:

February 22, 2008

Legend:

Taxpayer =

Company =

Partnership A =

Managing Entity =

Subsidiary 1 =

Subsidiary 2 =

Partnership B =

State A =

State B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

X =

Y =

Series Preferred Stock =

Dear :

This is in reply to a letter dated October 10, 2007, requesting a ruling on behalf of Taxpayer. Specifically, you requested a ruling concerning the treatment of gain from goodwill under sections 856(c)(2) and (3) of the Internal Revenue Code.

Facts:

Taxpayer is a domestic corporation that elected to be treated as a Real Estate Investment Trust ("REIT") under section 856(c) as of Year 1. Taxpayer's principal business was the ownership and management of community and neighborhood shopping centers throughout the United States. Taxpayer was also a publicly held corporation prior to the transaction that is the subject of this ruling. Through a wholly owned subsidiary, Taxpayer was the general partner in Partnership A, a State A limited partnership.

Managing Entity is a foreign real estate company specializing in the management and development of shopping centers. Company, a State B limited liability company, is indirectly owned by certain United States entities managed by Managing Entity. Subsidiary 1 and Subsidiary 2 are wholly owned subsidiaries of Company. Additionally, Subsidiary 2 and Company are the general and limited partners, respectively, of Partnership B, a limited partnership.

On Date 1, Taxpayer and Partnership A entered into a merger agreement to be acquired by Company and two of Company's wholly owned subsidiaries (Subsidiary 1 and Subsidiary 2). These three entities are hereinafter collectively referred to as the "Buyer Parties." Subsequently, on Date 2, Subsidiary 1 commenced a tender offer to purchase all outstanding shares of Taxpayer common stock for \$X per share. On Date 3, approximately Y percent of Taxpayer common stock had been purchased by Subsidiary 1 pursuant to the tender offer.

On Date 4, Taxpayer and Buyer Parties completed the other transactions of the merger agreement, pursuant to which (i) Subsidiary 1 merged with and into Taxpayer, with Taxpayer surviving the merger, and (ii) Partnership B merged with and into Partnership A, with Partnership A continuing as the surviving limited partnership. These two mergers are hereinafter collectively referred to as the "Merger." Pursuant to the

Merger, the remaining holders of Taxpayer common stock, other than Subsidiary 1, exchanged their stock for \$X per share. Additionally, holders of limited partnership units in Partnership A exchanged their limited partnership units for either \$X per unit or preferred units in Partnership A. The Merger resulted in Company owning all Taxpayer common stock, but no Taxpayer preferred stock. In addition, Taxpayer owned all common partnership units in Partnership A.

Immediately following the Merger, and as part of the same plan, the surviving Taxpayer was liquidated into Company on Date 4 (the "Liquidation"). All of Taxpayer's assets were transferred to, and all of its liabilities were assumed by Company. As part of the Liquidation, holders of Taxpayer's Series Preferred Stock received a liquidating distribution of cash in exchange for their stock.

Upon consummation of the Merger and Liquidation, all issued and outstanding Taxpayer common stock was converted into the right to receive \$X per share and preferred stockholders of Taxpayer Series Preferred Stock received liquidating cash distributions (the "Merger Consideration"). Additionally, all property, rights, privileges, powers and franchises of Taxpayer were vested in Company and all debts, liabilities, and duties of Taxpayer were assumed by Company as the successor company to Taxpayer. The Merger Consideration, together with the assumption of Taxpayer's debts, liabilities, and duties is referred to as the "Purchase Price."

Taxpayer and Company represent that for tax purposes, the transaction will be treated as (1) the sale of all stock of Taxpayer by the existing shareholders; (2) the liquidation of Taxpayer under section 331; and (3) a technical termination of Partnership A under section 708(b)(1)(B). They also represent that as a result of the Liquidation, Taxpayer will be treated as having made a taxable disposition of all of its assets under section 336.

Company, as successor of Taxpayer, will be required to file Taxpayer's final income tax statement for the short tax year ending on the date of Liquidation. To the extent the Purchase Price exceeds the aggregate estimated fair market value of Taxpayer's tangible assets at the time of the Merger, the excess will be treated under the residual method of section 1060 as allocable to intangibles. Taxpayer has characterized these intangible assets as "Goodwill." The Buyer Parties represent that they will treat the Goodwill as an amortizable intangible pursuant to section 197.

Taxpayer represents that if, upon Liquidation, all of Taxpayer's recognized gain attributable to Goodwill is considered nonqualifying income for the purposes of sections 856(c)(2) or (c)(3), Taxpayer would fail to satisfy the 95 percent gross income test under section 856(c)(2) and the 75 percent gross income test under section 856(c)(3), thereby failing to qualify as a REIT for its final taxable year.

Taxpayer requests a ruling that under section 856, Goodwill should be allocated among Taxpayer's assets in accordance with the relative fair market values of such

assets at the time of liquidation and that the Goodwill will have the same character as any gain that would be recognized upon a sale of such assets.

Law and Analysis:

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from (A) rents from real property; (B) interest on obligations secured by mortgages on real property or on interests in real property; (C) gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1); (D) dividends or other distributions from the sale or other disposition of transferable shares of other REITs; (E) abatements and refunds of taxes on real property; (F) income and gain derived from foreclosure property; (G) amounts (other than amounts the determination of which depends in whole or part on the income or profits of any person) received or accrued as consideration for entering into agreements (i) to make loans secured by mortgages on real property or (ii) to purchase or lease real property (including interests in real property and interests in mortgages on real property); (H) gain from the sale or other disposition of a real estate asset which is not a prohibited transaction solely by reason of section 857(b)(6); and (I) qualified temporary investment income.

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from the sources listed in section 856(c)(3); dividends; interest; and gain from the sale or disposition of stock or securities.

Section 1060 generally provides the method that is required to be used by a transferor to allocate the consideration received on the sale of assets that constitute a trade or business. Under section 1.1060-1(b)(2)(i) of the Income Tax Regulations, assets will be considered a trade or business if either (A) the use of such assets would constitute an active trade or business within the meaning of section 355 or (2) goodwill or going concern value could attach to the assets under any circumstance. Section 1.1060-1(b)(2)(ii) further provides that goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor. See *also Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 556 (1993).

Although the income and asset tests under section 856(c) require a REIT primarily to hold assets that generate passive income for purposes of subchapter M, a REIT may be considered an active trade or business for other areas of the Code. For example, Rev. Rul. 2001-29, 2001-1 C.B. 1348, provides that a self-managed REIT will be considered to be engaged in an active trade or business within the meaning of section 355. The revenue ruling concludes that a REIT's rental activity that produces income that qualifies as rents from real property under section 856(d) satisfies the active trade or business requirement of section 355(b) although that activity is considered "passive" for purposes of subchapter M.

It follows, therefore, that a REIT such as Taxpayer that is engaged in the trade or business of owning and managing community and neighborhood shopping centers (within the scope of subchapter M) will generate goodwill that increases the value of the REIT. Goodwill is inseparable from the business from which it arose. See Hatch's Estate v. Commissioner, 198 F.2d 26 (9th Cir. 1952); Pfleghar Hardware Specialty Company v. Blair, 30 F.2d 614 (2d Cir. 1929).

In this case, the assets that constitute Taxpayer's trade or business and directly or indirectly produce income for Taxpayer are integrally related to the goodwill generated by the trade or business. Although goodwill is treated as a separate asset for purposes of section 1060, it may be characterized for purposes of the REIT income tests based upon the characterization of the income produced by Taxpayer's activities in its trade or business. To the extent that Taxpayer's trade or business that generate goodwill produces qualifying income under either section 856(c)(2) or section 856(c)(3), gain from goodwill related to the trade or business will be treated as producing qualifying income for the purposes of the REIT income tests. For example, if the sale price of a shopping center is partially attributable to goodwill, the goodwill will be treated as generating the same type of income as the real property to which it relates, which in this case is the sale of real property. Accordingly, to the extent that gain derived from the sale of Taxpayer's trade or business produces qualifying income under sections 856(c)(2) or (3), gain allocated to goodwill that relates to the trade or business ("Goodwill Gain") will be treated for purposes of the REIT income tests as being derived proportionately from the same source as the gain recognized on the sale to which the Goodwill Gain relates.

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under section 1060 or any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code. In addition, we do not rule as to whether the intangibles characterized by taxpayer as Goodwill are in fact goodwill for federal income tax purposes.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)